**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
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| Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 | ) | CS Docket No. 98-82 |
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| Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 | ) | CS Docket No. 96-85 |
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| The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules | ) | MM Docket No. 92-264 |
| | ) | |
| Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests | ) | MM Docket No. 94-150<br>RM - _____ |
| | ) | |
| Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry | ) | MM Docket No. 92-51 |
| | ) | |
| Reexamination of the Commission's Cross-Interest Policy | ) | MM Docket No. 87-154 |

## REPLY COMMENTS OF THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

The National Cable & Telecommunications Association ("NCTA") hereby submits its reply comments in the above-captioned proceeding.

In its initial comments, NCTA showed that, because of changed marketplace circumstances, the potential problems that the horizontal and vertical ownership provisions of the 1992 Cable Act were intended to address had largely dissipated. Much of the legislative concern focused on the supposed ability and incentive of large, vertically integrated cable multiple system owners (MSOs) to favor their affiliated program networks in a manner that unfairly suppressed the development and distribution of diverse, unaffiliated programming. But, as NCTA showed, the "explosive growth in vertical relationships between cable operators and program suppliers"[1] that worried Congress not only did not continue but has been dramatically reversed. A far smaller percentage of program networks are now owned by cable operators, so that even if individual MSOs were to give preferential carriage to affiliated program networks, the impact on the availability and diversity of programming would be minimal.

Moreover, NCTA showed that the emergence and ubiquitous availability of DBS companies as full-fledged competitors of cable operators in the provision of multichannel video programming to subscribers has substantially eliminated the incentives of MSOs to favor affiliated services in a way that adversely or unfairly affects the flow of programming to consumers. When consumers can readily choose substitutable alternatives, a cable operator can ill afford to choose the services that it will carry on any basis other than their value and attractiveness to subscribers. Similarly, competition in the sale of video programming to consumers constrains the ability and incentive of even a large MSO to exercise market power in a manner that diminishes the value, attractiveness, diversity and quantity of programming that it is able to offer its subscribers.

NCTA's comments were accompanied and supported by an economic analysis by Professor Howard Shelanski. In addition, AT&T submitted, along with its comments, two comprehensive economic analyses explaining in greater and more technical detail why the anticompetitive conduct and adverse effects on programming that Congress feared in 1992 are

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1 Report of the Committee on Energy and Commerce of the House of Representatives, H.R. Rep. No. 92-628, 102d Cong., 2d Sess. 41 (1992).

unlikely to occur in the marketplace that currently exists.[2] Other parties, including not only cable operators but also the Progress and Freedom Foundation, agreed that the risks associated with size were small and that limiting the number of subscribers served by a single MSO – and, thereby limiting pro-competitive efficiencies – would likely do more harm than good. [3]

In addition, NCTA argued that if the Commission were nevertheless to adopt cable ownership caps, it should review and revise the current media ownership attribution rules so that they will be tailored to the purposes of each ownership restriction. The comments of Cablevision Systems Corporation provide additional support for such a rulemaking proceeding.[4]

There is little in the record that rebuts these arguments and economic analyses. Some parties, to be sure, propound the "big is bad" mantra – in some cases, at great length. But they provide no evidence of any anticompetitive conduct by cable MSOs. And they provide no economic analysis that explains why, in light of the reduction in vertical integration and the nationwide availability of competitive alternatives to incumbent cable operators, any such conduct should be expected to occur.

To the contrary, the comments of Consumer Federation of America, *et al*. simply <u>deny</u> that those changed circumstances have occurred and contend that the structural conditions that led Congress to adopt the horizontal and vertical ownership provisions in 1992 "continue to exist."[5] Thus, they claim that cable "is still vertically-integrated" and assert that "DBS is not a substitute for cable" and is "nothing more than a niche product purchased by people who cannot

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2 *See* Declarations of Janusz A. Ordover and Stanley Besen, Attachments A and B to Comments of AT&T Corp.

3 *See*, *e.g.*, Comments of Comcast Corporation; Comments of Progress & Freedom Foundation; Comments of Time Warner Cable.

4 *See* Comments of Cablevision Systems Corporation at 12-15.

5 CFA Comments at 120.

get cable . . . or viewers who are willing and able to purchase expensive specialty bundles, such as sports channels and foreign language services."[6]

These claims – which CFA has been recycling virtually verbatim for several years[7] – are crucial to CFA's arguments, but they are hopelessly outdated and wrong. First, because of the "dis-integration" of large companies that were formerly vertically integrated, the sharp decline in vertical integration has been obvious to the naked eye. Even prior to the spin-off of Liberty Media by AT&T, the Commission's annual reports on the status of video competition have each year documented the decline.

This year, according to the Commission, "vertical integration of national programming services between cable operators and programmers remained at 35 percent after several years of decline."[8] But that finding is misleading and masks the even sharper decline that resulted from the Liberty divestiture. Although Liberty's program networks are no longer vertically affiliated with AT&T's large number of cable systems (and most have no other cable operator ownership), Liberty continues to own several cable systems in Puerto Rico. Therefore, the Commission continues to count all of Liberty's networks as vertically integrated, even though the effect of such limited vertical integration on national concentration issues is minimal. If Liberty's program networks were treated as non-vertically integrated, as they should be, the percentage of vertically integrated networks would show a further decline, to as few as 22 percent.[9]

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6 *Id.* at 10.

7 *See*, *e.g.*, Consumer Federation of America and Consumer @ction, "Transforming the Information Superhighway Into a Private Toll Road: The Case Against Closed-Access Broadband Internet Systems" (1999) at 88 ("DBS fills a niche at the high end of the market . . . . DBS still costs more than twice as much as cable does, not including the front-end system costs") and at 68 ("Because the industry is horizontally concentrated and vertically integrated, the dominant firms control enough of the market to exercise price leadership").

8 *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eighth Annual Report, CS Docket No. 01-129, ¶14 (released Jan. 14, 2002) (emphasis added).

9 *See* Statement of Gregory L. Rosston and Howard A. Shelanski, attached to these reply comments, at 12 n.11.

Second, CFA's portrayal of DBS as a "niche" service that does not compete with cable is based on stale premises that have been invalid for years. As DirecTV's and EchoStar's own ubiquitous advertising makes clear, DBS has for several years been focusing its marketing efforts on existing cable subscribers in urban as well as suburban and rural areas. Its prices and program offerings are comparable to cable's. The high up-front costs cited by CFA long ago disappeared, with DBS companies now routinely offering free or highly discounted equipment and installation. And, thanks to the Satellite Home Viewer Improvement Act of 1999, DBS companies are no longer prohibited from providing local broadcast stations to their subscribers.

As long ago as 1998, the Department of Justice recognized that cable and DBS were competing nationwide for the same customers, with comparable services at comparable prices:

> Cable and DBS are both MVPD products. While the programming services are delivered via different technologies, <u>consumers view the services as similar and to a large degree substitutable</u>. Indeed, <u>most new DBS subscribers in recent years are former cable subscribers</u> who either stopped buying cable or downgraded their cable service once they purchased a DBS system.[10]

Since then, DBS's share of multichannel subscribers has continued to increase sharply each year while cable's share has declined. There is not a shred of evidence to support CFA's persistent contention that DBS remains a "niche" service that does not compete with cable.

In addition to basing its argument on the two completely erroneous premises that cable remains highly vertically integrated and lacks competition in the retail sale of its services to subscribers, CFA submits a lengthy economic discourse that is also fundamentally flawed across the board. To explain the flaws, NCTA is submitting with these reply comments an analysis prepared by Professor Shelanski and Professor Gregory Rosston.

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[10] *United States v. Primestar, Inc.*, No. 1:98CV01193, Complaint, ¶ 63 (D.D.C. May 12, 1998) (emphasis added).

As Shelanski and Rosston show, CFA completely misapplies the economic concepts, principles and indices that it cites. For example, CFA blurs and confuses the distinction between concentration in local markets for the sale of multichannel video programming services to consumers and concentration among MVPDs and other buyers of programming at the national level. It's the latter that is the focus of this proceeding, which is concerned with whether, at some point, concentration is likely to adversely affect the diversity and flow of programming to consumers – either by unfairly discriminating against unaffiliated program networks or by exercising monopsony power to suppress the quantity and quality of programming in a manner that harms consumers.

But much of CFA's analysis seems instead to be trying to show that consolidation of cable operators at the national level somehow increases the ability of cable operators to exercise monopoly power at the local level – even though mergers of cable operators who are not local competitors does nothing to affect local concentration. CFA's reliance on the Herfindahl-Hirschman and Lerman indices, as well as the "q-ratio," exemplifies this confused approach.[11] Competition at the local level is, indeed, relevant to the ability of cable operators to exercise monopsony power vis-à-vis program suppliers at the national level – but only, as we have shown, to the extent that competition from DBS companies and others constrains the ability and incentive to exercise such monopsony power.

CFA, however, fails to grasp this connection. "In the end," as Shelanski and Rosston point out, CFA "offers scant analysis to logically connect a horizontal ownership cap to the reduction of harms from monopsony conduct" and does not recognize "just how difficult and unlikely it would be for a cable operator to use its buying power to cause the harms

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[11] *See* Rosston and Shelanski at 22-26.

conventionally ascribed to monopsony."[12] As Shelanski and Rosston explain, "If the cable operator were not large enough to dictate the nature of programming for the market as a whole, then the large cable operator would face competition from rivals who, in the effort to attract subscribers from cable, purchase better quality programming than what the cable operator has purchased."[13]

But even if a cable operator had such a large share of subscribers nationwide that it might otherwise be in a position to exercise monopsony power, its incentive to do so would be severely constrained by the presence of competition from DBS and other local retail competitors. As Shelanski and Rosston explain,

> [b]ecause cable operators face competition from at least two DBS competitors in local markets, reducing the quality and diversity of available programming through monopsony would be unlikely to yield gains for the cable operator. Such monopsony conduct would not get rid of cable's local rivals, but instead would reduce competition based on differentiated programming and increase competition on price, the dimension of program quality being foreclosed by the cable operator's monopsonistic behavior. But, as the MVPD competitors vie for subscribers by lowering prices, any rents the large cable company gained from its monopsony conduct upstream would likely be dissipated, and this is especially harmful to operators in an industry with high fixed costs. Monopsony has yielded little to the cable operator individually, and may have hurt MVPD providers collectively by making their video services less attractive to existing customers and less likely to entice new subscribers.[14]

Thus, despite its length, CFA's attempt to demonstrate that horizontal integration is likely to result in harmful anticompetitive conduct misses the mark. As NCTA showed in its initial comments, especially in light of the decline in vertical integration and the ubiquitous competitive availability of DBS, ownership caps that are based on the expectation of such conduct will similarly miss the mark and will only interfere with potential procompetitive efficiencies and

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12 *Id.* at 6-7.

13 *Id.* at 7.

14 *Id.* at 16.

benefits. The record provides additional support for this conclusion – and nothing that undermines it.

Respectfully submitted,

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